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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927.

No. 210

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

OLNEY-LEIN MACHINE COMPANY.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

BRIEF FOR THE RESPONDENT.

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No. 210

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v.

OESTERLEIN MACHINE COMPANY.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

BRIEF FOR THE RESPONDENT.

Opinion Below.

The opinion of the court below is reported in 17 F. (2d), 663, and is printed at page 44 of the record.

Jurisdiction.

The judgment of the court of appeals for review was entered January 3, 1927 (R., 49). The petition for

certiorari was filed April 2, 1927, and granted pursuant to Section 240(*a*) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

The real issues involved are:

1. Does the United States Board of Tax Appeals have jurisdiction to review and determine all deficiencies?

and if it does:

2. Has the Board authority to compel witnesses to testify as to facts which have, by an act of Congress, been made material to the issue before the Board?

3. In the case of an appeal filed after the enactment of the Revenue Act of 1924 and before the enactment of the Revenue Act of 1926, does the Board have jurisdiction of a net deficiency determined in respect to two years covered by the same deficiency letter?

The Facts and History of the Case.

The petitioner is the Commissioner of Internal Revenue.

The respondent, a corporation, is a manufacturer of machine tools and has its place of business at Cincinnati, Ohio. It duly filed income and profits tax returns for the calendar taxable years 1918, 1919, and 1920 (R., 11). It was a close-held corporation and had poor records to show how much had been invested in plant,

etc., in the past. When the petitioner audited respondent's 1917 income and profits tax return he found that such poor records prevented him from determining accurately and satisfactorily the invested capital of the corporation (R., 2, paragraphs 8 and 10). He, therefore, determined respondent's profits tax liability under the provisions of Section 210, Revenue Act of 1917, 40 Stat., 307, which section is quoted as Appendix A herein.

When the petitioner audited respondent's 1918 return the same conditions existed that had existed in the audit as to 1917, and he determined the respondent's profits tax liability under the provisions of Section 328, Revenue Act of 1918, upon the basis of the average percentage of income paid as profits taxes by corporations determined by the petitioner to be representative. (R., 4, Par. 16. Also, R., 9.)

Upon auditing respondent's 1919 return the petitioner refused to determine its profits tax liability under the provisions of said Section 328, but determined it under Section 301, Revenue Act of 1918, upon the basis of an invested capital which he arrived at in some manner not known to your respondent, although as to prior years he had confessed inability to determine invested capital. (R., 4, Par., 16-18; also, R., 9.)

A final deficiency letter was mailed by the petitioner to your respondent, under date of June 28, 1924, claiming the existence of deficiencies of $10,240.09 for 1919, and $182.45 for 1920, offset in part by an over-assessment of $9,296.17 for 1918, or a net deficiency of $1,026.37 for the three years. The United States Board

of Tax Appeals had just been created under date of June 2, 1924, (Sec., 900, Revenue Act of 1924; 43 Stat., 336; U. S. C. Title 26, Ch. 22, Sec., 1211, *et seq.*,) and the respondent within sixty days after the mailing of said letter, under the provisions of Sec. 274, Revenue Act of 1924, duly filed an appeal to the said Board of Tax Appeals in regard to the calendar taxable years 1918 and 1919, in respect to which years the petitioner had determined a net deficiency of $943.92 (R., 15).

The respondent claimed, among other errors, that as to 1918 the petitioner had erred in that in arriving at the amount of respondent's tax liability under said Section 328 petitioner had obtained an unduly high rate by failing to compare your respondent with corporations which were truly "representative" of your respondent's business, and "comparable" as to the various factors mentioned in said section.

As to the year 1919 the respondent claimed the petitioner erred in failing to compute its profits tax liability under the provisions of said Section 328, and in computing it under Section 301.

No appeal was made as to the year 1920.

The petitioner answered denying most of the allegations (R., 15). The case was set for trial and in preparing for trial your respondent requested said Board to issue an order to take the depositions of certain other taxpayers alleged by the respondent to be "representative" and "comparable" (R., 5, Par. 24). The petitioner moved to strike the application for an order to take depositions on the ground that the Commissioner of Internal Revenue had exclusive and sole

jurisdiction of the determination of deficiencies under Sections 327 and 328. (R., 5, Par. 25.) Arguments on said motion were heard by the Board and, after careful consideration it decided that it had jurisdiction of deficiencies determined under the provisions of said Section 328. (R., 5, Par. 26; also, R., 17.)

The respondent also applied to the Board in accordance with the provisions of Section 900 (*i*), (3), Revenue Act of 1924, for an order requiring the Commissioner to answer in writing under oath certain questions seeking to elicit how he had arrived at the 1918 tax under Section 328, the names of the companies he had determined to be "representative" and "comparable" and certain facts and data in regard to said companies and others which the respondent claimed were more truly "representative" and "comparable," such as the sales, expenses, income and taxes finally determined by the Commissioner to be due from said companies (R., 28).

After a hearing on said application the Board found the facts requested were material to the issue and issued the subpœna.

The Board issued the subpœna only after mature consideration of all the objections raised in this proceeding as will be seen from its very learned opinion (R., page 17, 1 B. T. A., 159). See also the Board's order denying respondent's motion that it proceed in court (R., 36). The Board being a quasi-judicial body, a part of the executive branch of the Government, is given authority to require the attendance of witnesses, the production of returns, books, papers, etc., the taking of depositions, and the answer in writing under

oath to any question of fact submitted. (See 900 (*i*), Revenue Act of 1924.)

If any person refuses to testify or produce records or answer in writing as to any question of fact, it is necessary either for the Board or the aggrieved party to proceed, in accordance with Section 1025, Revenue Act of 1924 to obtain a court order compelling such person to obey the order or subpœna of the Board.

The Commissioner refused to obey the subpœna on the ground the information was confidential, and that to divulge it would violate the provisions of R. S. 3167, and Section 257 (*a*), Revenue Act of 1924 (R., 34). Thereupon the respondent applied to the judges of the Supreme Court of the District of Columbia, in accordance with the provisions of Section 1025, Revenue Act of 1924 (43 Stat., 348; U. S. C., Title 26, Ch. 23, Sec. 1258, *et seq.*), for an order compelling the Commissioner to obey the subpœna and orders of the Board (R., 1). A rule to show cause was issued (R., 38). The petitioner answered (R., 38) and moved to dismiss the respondent's pleading (R., 41). Mr. Justice Hoehling denied the Commissioner's motion and ordered the Commissioner to obey the Board's subpœna and orders (R., 42).

The Commissioner appealed to the Court of Appeals of the District of Columbia (R., 42-43) and after a hearing the latter court affirmed the decree of the lower court. The Commissioner made application to this Court for the issuance of a writ of certiorari, which was granted.

Apparently the petitioner has, in appearing before this Court, abandoned the contention, made below, that

the penal statutes, R. S. 3167, and Sec. 257, Revenue Act of 1924, would be violated.

Summary of Respondent's Argument.

I. The information which the petitioner refused to furnish to the United States Board of Tax Appeals is the best evidence of facts which Congress made material to the issue before said Board and is concededly indispensable if the Board is to review the petitioner's determination of a deficiency involving the application of the special assessment provisions of the revenue acts.

II. The legislative history of the investigation of the Bureau of Internal Revenue and the creation of the United States Board of Tax Appeals shows that it was the intention of Congress to give the Board jurisdiction of *all deficiencies* determined by the petitioner after the enactment of the Revenue Act of 1924, regardless of the extent of the petitioner's authority under prior revenue acts.

III. The statutes conferring jurisdiction on the United States Board of Tax Appeals provide that the Board shall have jurisdiction of *all deficiencies* determined by the petitioner after the enactment of the Revenue Act of 1924, and do not provide for any exception, express or implied, in cases involving the application of the special assessment provisions of the revenue acts.

IV. Even before the enactment of the Revenue Act of 1924, the petitioner had no unreviewable discretion

under the special assessment provisions of the Revenue Act of 1918, as shown by:

(*a*) Reference to Section 327 of said act.

(*b*) Reference to other sections of said act, using language similar to that used in Section 327.

(*c*) Reference to Section 328 of said act.

V. The Board has jurisdiction to review the petitioner's determination for both the years 1918 and 1919, as Section 274 (*g*) of the Revenue Act of 1926 does not affect appeals filed with the Board prior to the enactment of said act.

VI. The recent decisions of the United States Court of Claims, in the case of *Williamsport Wire Rope Company v. The United States*, and of the United States District Court for the Northern District of Ohio in the case of *The Feilbach Company v. Niles, Collector*, are not in point in a case involving the jurisdiction of the United States Board of Tax Appeals.

ARGUMENT.

I.

The information which the petitioner refused to furnish to the United States Board of Tax Appeals is the best evidence of facts which Congress made material to the issue before said Board and is concededly indispensable if the Board is to review the petitioner's determination of a deficiency involving the application of the special assessment provisions of the revenue acts.

This proceeding in the Federal courts is merely incidental to a proceeding in the United States Board of Tax Appeals which has not yet come to trial. It was instituted to assemble evidence for use in the trial before said Board. It apparently has been conceded all along that the said Board could not fully review the action of the Commissioner of Internal Revenue in this case without having produced before it the facts asked for in the subpœna issued by the Board. The Board issued the subpœna only after a hearing and after it had satisfied itself that your respondent was not attempting any "fishing expedition" in the Commissioner's files, and that the facts asked for were material to the issue.

The task of the Board is to determine the tax liability and any resulting deficiency in a trial *de novo* in which the rules of evidence in effect in the District of Columbia govern the procedure. The Board has be-

fore it none of the returns, revenue agent's reports, or other data in the Commissioner's files. It has before it only facts which are plead and admitted in the Commissioner's answer (as a matter of practice the Commissioner admits few facts, except those showing jurisdiction), and such facts as are introduced in evidence by the parties.

The Commissioner's records are the best evidence of the facts asked for in the subpœna. A taxpayer's *returns* are self-serving declarations; many figures thereon being changed by the Commissioner's audit. It should be noted that the respondent has not asked for the production of any return. It has merely asked for testimony as to the income, amount of tax paid, and other data less important, as such figures appeared *after* the Commissioner audited the *returns* of twelve corporations engaged in the same business.

Your respondent, therefore, has requested the production of facts (*a*) which have been made by Congress material to the issue before the Board; (*b*) which are in the form of the best evidence of such facts; and (*c*) which are concededly indispensable if the Board is to review the Commissioner's actions in your respondent's case.

II.

The legislative history of the investigation of the Bureau of Internal Revenue and the creation of the United States Board of Tax Appeals shows that it was the intention of Congress to give the Board jurisdiction of all deficiencies determined by the petitioner after the enactment of the Revenue Act of 1924, regardless of the extent of the petitioner's authority under prior revenue acts.

The Board of Tax Appeals was created by Congress by Section 900, Revenue Act of 1924, and the last sentence of said section provides that:

> "The Board shall be an independent agency in the executive branch of the Government."

The main trend of the petitioner's argument in this case is to the effect that the judgment below should be reversed on the basis of language contained in an act enacted five years before a Board of Tax Appeals was thought of or created by Congress.

Let us consider the legislative history in connection with the establishment of the Board of Tax Appeals.

As early as December 11, 1923, Senator King (Utah) introduced a resolution (Senate Res., 56, Vol. 65, Cong. Rec., p. 231), seeking an investigation of the Commissioner's administration of the Bureau of Internal Revenue, and to consider the advisability of establishing a court or public tribunal to handle tax claims.

Under date of February 21, 1924, Senator Couzens (Michigan) introduced a resolution (Senate Res., 168, Vol. 65, Cong. Record, p. 2947), also criticizing the petitioner's administration and recommending the appointment of a committee to investigate the same.

On March 12, 1924, said resolution was adopted by the Senate.

The subject of the Commissioner's tax determinations under the provisions of Sections 327 and 328, Revenue Act of 1918, was one of the first investigated. On March 20, 1924, the petitioner submitted to said Committee a statement in regard to the difficulties of his administration, and at page 136 thereof appears a statement of the duties of the so-called "Special Assessment Section." As early as March 24, 1924, a former employee in said section of the Bureau of Internal Revenue was called as a witness. His testimony appears at page 203 *et seq.*, of the Reports of the Hearings before the said Committee, and on page 211 thereof, he admits that when he was in the Bureau he selected the *highest* comparatives that he could in arriving at an average tax under said Section 328.

When said Committee rendered its report (Senate Report, No. 27, Parts One and Two, 69th Congress, 1st Session), it set forth fully the facts showing unexplainable and inconsistent action under said Section 328 by the petitioner herein.

The above is cited, not as a criticism of the petitioner herein, but merely to show the situation as it existed in Congress when it considered creating some body independent of the Bureau of Internal Revenue

and the Treasury Department. Needless to say, we do not find in any of the reports of the petitioner's appearances before said investigating Committee any of the claims being made herein about having "unreviewable discretion," etc.

The above Committee was not the only Congressional Committee which considered the existing situation in said Bureau. The House Ways and Means Committee and the Senate Finance Committee shortly thereafter started considering revision of the Revenue Act of 1921, and the following are extracts from the reports of the House and Senate committees as to conditions which caused Congress to create the Board of Tax Appeals:

> "The Committee recommends the establishment of a Board of Tax Appeals to which a taxpayer may appeal *prior to the payment of an additional assessment* of income, excess-profits, war-profits, or estate taxes." (House Report No. 179, 68th Congress, 1st Session, p. 7.)
>
> "*Under the existing law a taxpayer prior to the payment of his tax may appeal to the Commissioner, who has established the Committee on Appeals and Review, to determine these appeals for him.* The objections that have been raised to this procedure are four: (1) The appeal is from the action of the Bureau of Internal Revenue but is taken to a committee in and a part of the bureau. It is urged that *such an appeal does not involve a review by an impartial outside body*, such as the taxpayer is entitled to prior to payment of the tax. (2) In the hearing on the appeal the person who is to decide

the appeal acts *both as advocate and judge,* since he must both protect the interest of the Government and decide the questions involved. Such conditions do not insure an impartial determination of the case. (3) If the decision on the appeal is in favor of the Government, the taxpayer has the right to test the correctness of the decision in the courts, but if the decision is in favor of the taxpayer, the action of the bureau is final and the correctness of the decision can never be tested in the courts. It is contended that this condition results in the decision of most doubtful points in favor of the Government. (4) The taxpayer is usually forced to come to Washington for the hearing on his appeal, an expensive and burdensome procedure." (Id., pp. 7 and 8.)

"*To meet the objections given above, the committee recommends that there be established a Board of Tax Appeals.*"

* * * "*Both the Government and the taxpayer will appear before the Board and present their cases, and the decision of the Board will be final as to the amount of tax to be paid.*" (Id., p. 8.)

"The bill provides for the establishment of a Board of Tax Appeals to which a taxpayer may appeal *prior to the payment of an additional assessment* of income, excess-profits, war-profits, or estate taxes. * * *"

"Under the existing law a taxpayer prior to the payment of his tax may appeal to the Commissioner, *who has established the Committee on Appeals and Review to determine these appeals for him.*"

"Under the provisions of the proposed bill creating a Board of Tax Appeals the taxpayer may, *prior to the payment of the additional assessment of income, war-profits, excess-profits, or estate taxes, appeal to the Board of Tax Appeals* and secure an impartial and disinterested determination of the issues involved. In the consideration of the appeal *both the Government and the taxpayer will appear before the Board to present their cases,* with the result that each member of the Board will sit solely as judge and not as both judge and advocate."

"* * * *This proposal meets all the objections that have been raised as to the existing system* and at the same time provides for a flexible and informal procedure which will permit the Board to determine expeditiously the cases brought before it on appeal." (Senate Report 398, 68th Congress, 1st Session, pp. 8 and 9.)

We can concede that prior to June 2, 1924, the Commissioner of Internal Revenue was the *sole Administrative official* having authority to determine deficiencies in tax. His actions were reviewable only by the courts, either in a common law form of action against a Collector of Internal Revenue, or against the United States under the so-called Tucker Act.

Congress apparently thought it advisable to divide such authority, and, after the enactment of the Revenue Act of 1924, there were *two* administrative bodies, instead of only one, charged with the above duties. But the Board was to have jurisdiction only where a taxpayer evidenced his dissatisfaction with the Com-

missioner's determination by the filing of an appeal with the Board. If he did appeal, the Commissioner could not assess the tax but must await the Board's determination.

We assert, therefore, that the jurisdiction of the Board in this case depends upon the language of the statute creating the Board, and not upon the language used in an act enacted during the war years when the Commissioner was the *sole* executive official charged with the duty of determining deficiencies.

III.

The statutes conferring jurisdiction on the United States Board of Tax Appeals provide that the Board shall have jurisdiction of all deficiencies determined by the petitioner after the enactment of the Revenue Act of 1924, and do not provide for any exception, express or implied, in cases involving the application of the special assessment provisions of the revenue acts.

The pertinent provisions of the Revenue Act of 1924 are as follows:

Section 273 provides:

> "Section 273. As used in this title the term 'deficiency' means—
>
> "(1) The amount by which the tax imposed by this title exceeds the amount shown as the tax by the taxpayer upon his return; but the amount so shown on the return shall first be increased by the amounts previously assessed (or collected without assessment) as a defi-

ciency, and decreased by the amounts previously abated, credited, or refunded, or otherwise repaid in respect of such tax; or

"(2) If no amount is shown as the tax by the taxpayer * * * upon his return, or if no return is made by the taxpayer then the amount by which the tax exceeds the amounts previously assessed." (43 Stat., 253, 273.)

Please note that "deficiency" is defined as a difference without any reference to any particular law or section of any law under which the difference or deficiency is calculated.

Section 274 provides:

"Section 274(*a*) If in the case of *any* taxpayer the Commissioner determines that there *is* a *deficiency* in respect of the tax imposed by this *title*, the taxpayer, except as provided in subdivision (*d*) (the emergency assessment provision) shall be notified of such deficiency by registered mail, but such deficiency shall be assessed only as hereinafter provided. Within 60 days after such notice is mailed the taxpayer may file an appeal with the Board of Tax Appeals established by Section 900.

"(*b*) If the Board determines that there is a deficiency, the amount so determined shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the Board, shall be assessed, but a proceeding in court may be begun without assessment, for the collection of any part of the amount so disallowed." (43 Stat., 253, 297.) (Italics supplied.)

Section 280 provides that while taxes *imposed* by acts prior to the Revenue Act of 1924 are computed under those acts, they are to be *assessed, collected and paid* in the same manner and subject to the same provisions and limitations as taxes imposed under the Revenue Act of 1924. (43 Stat., 253, 301.)

The use of the words "any taxpayer" and "a deficiency" in Section 274 are so plain that any exception would have to be very clearly stated to rebut or even cause any doubt as to Congress' intention to make *all* deficiencies reviewable, especially deficiencies determined under Section 328, which had been the subject of special investigation and criticism by the Congressional Committee.

The court below would have had to indulge in *legislation* not *construction* to have held with the petitioner herein.

There is no ground for an *implied* exception in this question. As remarked by the Board in its opinion in this case (1 B. T. A., 159, 161; Record p. 17 *et seq.*),

> "the manner of assessment and collection of all such deficiencies is controlled by Title II of the Revenue Act of 1924, and is applicable to each and every section of the title not expressly excepted."

That this is true is evidenced by the fact that Congress deemed it necessary, in a case intended to be exempted, to make express provision therefor. Such exception appears in Section 278 of the Revenue Act of 1924, which provides, in part, as follows:

> "Section 278 * * * (*b*) Any deficiency attributable to a change in a deduction tentatively allowed under paragraph (9) of subdivision (*a*) of Section 214, or paragraph (8) of subdivision (*a*) of Section 234 of the Revenue Act of 1918 or the Revenue Act of 1921, may be assessed, or proceeding in court for the collection of any such tax may be begun without assessment, at any time."

(The above exception refers to a deduction for the amortization of war facilities.)

Congress also excepted deficiencies in the various excise taxes (all but estate taxes).

The Revenue Act of 1924 is full of express statutory exceptions, showing that Congress always resorted to express statutory exceptions where it intended to make an exception. In fact, it is well recognized that the Revenue Act of 1924 is a marvel of construction in that its draftsmen have by involved cross references attempted to cover every kind of a tax situation which might arise. A reading of the loss and gain provisions, Sections 202, 203 and 204, as well as the above Section 278 (*b*), forcibly illustrates this. Therefore, when we have draftsmen of said Revenue Act, who plainly have tried to leave *nothing* to implication, and when they have drafted and Congress has enacted a law giving the Board jurisdiction of *appeals* filed under Section 274, etc., and when Section 274 provides that in the case of "any taxpayer," the Commissioner determines there is "a deficiency" and such taxpayer appeals, the deficiency can be assessed only after re-

view and determination by the Board, we have absolutely no ground in the Revenue Act of 1924 to indulge in any implication as to the jurisdiction of the Board.

While respondent claims that the language of the 1918 Act cannot properly be considered in construing the *1924 Act*, especially when there was no thought of a Board of Tax Appeals in 1918 and 1919, and the 1924 Act created that innovation, let us analyze the particular sections of the 1918 Act relied upon by the petitioner herein as the grounds for an *implied* exception applicable to the 1924 Act.

War profits taxes were levied on the plan of first allowing to go free from said tax the average rate of profits earned on the capital invested during a "prewar" period. Many corporations were close-held, had been organized as far back as 1850 or earlier, and had not an accurate record of all sums invested in the business. Invested capital was based on *cost* of assets and, in the case of assets paid into a corporation for stock, on the "actual cash value" at the time paid in. Foreign corporations had part of their capital invested in this country and part elsewhere.

Congress foresaw that many corporations could not produce a record of the *cost* of their assets; that great difficulties would arise in determining the "actual cash value" of assets acquired many years ago; and in determining the portion of a foreign corporation's capital applicable to the production of income earned in the United States. It also saw that some corporations which, for instance, had earned profits chiefly with the use of borrowed capital, or through rendering personal

services, or had never paid its officers the value of services received (the corporation being close-held), would be required to pay an unreasonably high tax if it were computed under the regular method provided in Section 301, Revenue Act of 1918.

Congress therefore wisely devised a method of arriving at a profits tax liability in such cases, which would not result in extortion. It provided that all foreign corporations and all domestic corporations falling in classes such as mentioned above should pay an average tax arrived at by averaging the percentage of net income paid as profits taxes by other "representative" corporations engaged in the same business and comparable as to size and other measurements expressly stated in Section 328.

IV (a)

Even before the enactment of the Revenue Act of 1924 the petitioner had no unreviewable discretion under the special assessment provisions of the Revenue Act of 1918, as shown by:

(a) Reference to Section 327 of the 1918 Act.

Let us quote herein and analyze Sections 327 and 328 to see whether even before the enactment of the Revenue Act of 1924 the Commissioner was entrusted with "unreviewable discretion" in their administration.

> "Section 327. That in the following cases the tax *shall* be determined as provided in Section 328:" (Italics supplied.)

The above is a *command*, a *direction*, not a mere license.

> "(*a*) Where the Commissioner is unable to determine the invested capital as provided in Section 326;"

Merely because the word "Commissioner" is used does not warrant the assumption of kingly precepts. Naturally the Commissioner, charged with the duty of auditing all returns, would be mentioned. As the Board of Tax Appeals stated in its opinion (1 B. T. A., 159, *et seq.*, R., 20), "It is not discretionary with him whether he shall be unable so to determine. It specifically makes his inability so to determine the test." If this connotes "unreviewable discretion" in respect to Sections 327 and 328, the Commissioner can well argue conversely that this language gives him unreviewable discretion on all questions concerning the determination of invested capital under the provisions of Section 326.

> "(*b*) In the case of a foreign corporation:"

If the Commissioner's claim herein is correct, it would mean that *all* foreign corporations would be subject to a secret tax, levied by an administrative official, without a right of review by the courts or the Board of Tax Appeals. There is nothing in Section 327 (*b*) to indicate that Congress intended such a situation. Neither do we believe it intended a different rule to apply as to domestic corporations whose cases fall within the other paragraphs of Section 327.

"(*c*) Where a mixed aggregate of tangible property and intangible property has been paid in for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively."

In the determination of invested capital under Section 326, certain statutory limitations are placed upon the amount of intangible values allowed in invested capital. The value of property paid in for bonds is *not* allowed in invested capital. Suppose, for example, that in 1850 a mixed aggregate of tangible and intangible property was paid into a close held corporation for bonds, preferred stock and common stock. The bonds were not issued for any specific property, neither was the stock. Therefore neither the present officers of the corporation, the Commissioner or even a magician could determine the invested capital in accordance with the rules enacted by Congress in Section 326. Here again, if this paragraph gives "unreviewable discretion," the Commissioner may also well claim similar discretion in respect to all invested capital questions under Section 326.

"(*d*) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section, would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross dispro-

portion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in Section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under Section 233 of Title II) consists of gains, profits, commissions or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive."

Whether a "hardship" exists is easily determined. If A Company pays out 60 per cent of its net income as profits tax because it operates on borrowed capital, or some similar abnormal condition, while B Company only pays 20 per cent, it requires no involved proceeding or special training to discern a "hardship." So, also, if a corporation used borrowed capital of $500,000 and invested capital of $100,000, whereas competitors having the same size business, used borrowed capital $30,000 and invested capital $570,000, does it require some mysterious process to arrive at the conclusion that the company was operating under "abnormal" conditions?

IV (b)

Reference to other sections of said act using language similar to that used in Section 327.

Does the direction that he "find" and "declare of record" that a "hardship" or "abnormality" exists have any peculiar significance? The various revenue acts are full of similar directory language in sections of the law which have been reviewed time and again by the courts and by the Board of Tax Appeals.

Section 203, Revenue Act of 1918, provides:

> "That whenever *in the opinion of the Commissioner* the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner with the approval of the Secretary, may prescribe as *conforming* as nearly as may be to the best *accounting practice* in the trade or business, and as most clearly reflecting the income." (Italics ours.)

Whether inventories are necessary to reflect income and what is the best accounting practice is a subject which has been reviewed by the Board of Tax Appeals in the following and many other cases, *in which the Commissioner has acquiesced:*

Appeal of Buss Company, 2 B. T. A., 266;

Appeal of George C. Peterson Company, 1 B. T. A., 690;

Appeal of When Clothing Company, 1 B. T. A., 973;

Appeal of Champion Stove Company, 1 B. T. A., 656;

In Section 204(*b*) it is provided that:

> "(*b*) If for any taxable year * * * it appears upon the production of evidence *satisfactory to the Commissioner* that any taxpayer sustained a net loss, the amount of such net loss shall under regulations prescribed by the Commissioner with the approval of the Secretary be deducted from the net income of the taxpayer for the preceding taxable year * * *." (Italics ours).

A "net loss" is defined by statute in Section 204(*a*). This question has, in spite of said language, been the subject of litigation before the Board and the courts.

Appeal of J. J. Harrington, 1 B. T. A., 11;

Appeal of Butler Warehouses, Inc., 1 B. T. A., 1388.

and many others:

Auburn & Alton Coal Company *v.* U. S., decided, United States Court of Claims, January 18, 1926.

In Section 212(*b*), Revenue Act of 1918, it is provided that where a taxpayer's books do not clearly reflect his income—

> "The computation shall be made upon such basis and in such manner as in the opinion of

> the Commissioner does clearly reflect the income * * *."

The Commissioner has never claimed he had unreviewable "discretion" under Section 212(*b*). Appeals under this provision have been decided by the Board in the following cases:

Appeal of David Welch, 2 B. T. A., 64;
Appeal of Theresa Goodman, 1 B. T. A., 915;
Appeal of Henry Birn, 1 B. T. A., 416;
Appeal of Harry and Kate Cannon, 1 B. T. A., 720;
Appeal of Max and Jennie Kass, 1 B. T. A., 1115;
Appeal of Morris Feuer, 1 B. T. A., 1113;
Appeal of Union Market, Inc., 2 B. T. A., 429.

It has also been reviewed in court—

In re The U. S. Metal Goods Company, 4 Fed. (2d), 871.
In re Max Sheinman, Bankrupt, July 30, 1926, U. S. District Court, E. D. of Pa., 14 Fed. (2d), 323.

Under Section 214(*a*), (1), deductions are allowed in determining net income for

> "(1) All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries * * *."

Under Section 214(*a*), (8), deductions are also allowed for—

> "(8) a reasonable allowance for the exhaustion, wear and tear of property * * *."

and under Section 214(*a*), (10), in the case of mines, oil and gas wells, etc.,

> "(10) a reasonable allowance for depletion * * *."

The determination of what is "ordinary and necessary" and what is "reasonable" involves the use of mature judgment, but the Commissioner's guess on these subjects is plainly reviewable.

Appeal of L. S. Dickey Grocery Co., 1 B. T. A., 108;
Appeal of The Farmers Grain Co., 1 B. T. A., 605;
Appeal of Arthur H. Ingle, 1 B. T. A., 595.

and many others.

Alworth Stephans Co. *v.* Lynch, 278 Fed., 959;
Camp Bird, Ltd. *v.* Howbert, 262 Fed., 114;
Cohen *v.* Lowe, 234 Fed., 474;
N. C., St. L. Ry. Co. *v.* U. S., 269 Fed., 351.

Under Section 214 (*a*), (12), (*b*), if it is shown "to the satisfaction of the Commissioner" that a substantial loss was sustained in 1919 in disposing of the inventory on hand at the end of 1918, such loss could be used to reduce 1918 income. It has never been claimed that the Commissioner's failure to find a substantial loss was not reviewable.

Under Section 222 certain credits are allowed for taxes paid to foreign countries upon income derived from sources therein and subdivision (*c*) provides—

> "(*c*) These credits shall be allowed only if the taxpayer furnished evidence *satisfactory to the Commissioner* showing the amount of such income derived from sources within such foreign country or such possession of the United States, and all other information necessary for the computation of such taxes." (Italics supplied.)

The intent of this section is merely to make it clear that the taxpayer claiming the deduction shall have the burden of obtaining all necessary proof from the foreign country, but if the Commissioner, through prejudice, refused to give due effect to the evidence could it be said that his refusal to grant the deduction could not be reviewed?

In Section 326 (*a*), (2), invested capital is defined to include—

> "(*a*) Actual cash value of tangible property other than cash bona fide paid in for stock or shares * * * but in *no case* to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in *is shown to the satisfaction of the Commissioner* to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid in surplus"; * * * (Italics ours.)

The following cases in which courts have undertaken to review the judgment of the Commissioner in valua-

tion cases show that the vagueness existing in value determinations has not induced the courts to regard the Commissioner's right as in any sense discretionary:

As to value of legacies and decedent's estates under Estate Tax:

Curley *v.* Tait, 276 Fed., 840;
Dugan *v.* Miles, 276 Fed., 401;
Herold *v.* Kahn, 159 Fed., 608.

As to basic value (December 31, 1908, or March 1, 1913):

Safe Deposit Co. *v.* Miles, 273 Fed., 822; Affd., 259 U. S., 247;
Towne *v.* McElligott, 274 Fed., 960;
Pitney *v.* Duffy, 291 Fed., 621;
Lynch *v.* Turrish, 247 U. S., 221;
Walter *v.* Duffy, 277 Fed., 41;
Great Northern Ry. Co. *v.* Lynch, 545 U. S. Tax Cases, 241;
Hays *v.* Gauley Mtn. Coal Co., 247 U. S., 189.

As to value of property included in invested capital:

Castner, Curren & Bullitt *v.* Lederer, 275 Fed., 221;
Allworth Stephens Co. *v.* Lynch, 278 Fed., 959.

As to value for purposes of depletion:

Allworth Stephens Co. *v.* Lynch, *supra.*

As to depreciation allowable:

Camp Bird, Ltd. *v.* Howbert, 262 Fed., 114;
Cohen *v.* Lowe, 234 Fed., 474;
N. C. & St. L. Ry. Co. *v.* U. S., 269 Fed., 351.

As to value of capital stock under capital stock tax:
Central Union Trust Co. *v.* Edwards, 282 Fed., 324.

It, therefore, appears that Congress, in enacting the Revenue Act of 1918, was *lavish* in using all through the Act such phrases as "to the satisfaction of the Commissioner," "whenever in the opinion of the Commissioner," "reasonable allowance," etc. If the force and effect is given to such language as claimed by the Commissioner of Internal Revenue he would have more power than any cabinet officer, the President of the United States, or the whole Judiciary. That would be highly pleasing and complimentary to an official in charge of only one of the many Bureaus of the Treasury Department. But it is not quite so complimentary when we read all these quotations from the 1918 Act in connection with the legislative history cited herein regarding investigations of his administration and the determination by Congress that it was necessary to establish an executive body to review all his determinations before he would be allowed to assess a deficiency in tax.

IV (c)

Reference to Section 328 of said act.

Having analyzed Section 327, let us also consider Section 328, Revenue Act of 1918, which reads as follows:

> "SEC. 328 (*a*) In the cases specified in section 327 the tax *shall be* the amount which bears the same ratio to the net income of the taxpayer

(in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year. In the case of a foreign corporation the tax *shall be computed* without deducting the specific exemption of $3,000 either for the taxpayer or the representative corporations.

"In computing the tax under this section *the Commissioner shall compare* the taxpayer only with representative corporations whose invested capital can be satisfactorily determined under section 326 and which are, as nearly as may be, similarly circumstanced with respect to gross income, net income, profits per unit of business transacted and capital employed, the amount and rate of war profits or excess profits, and all other relevant facts and circumstances.

"(*b*) For the purposes of subdivision (*a*) the ratios between the average tax and the average net income of representative corporations shall be determined by the Commissioner in accordance with regulations prescribed by him with the approval of the Secretary.

* * * * * * *

"(*c*) The Commissioner shall keep a record of all cases in which the tax is determined in the manner prescribed in subdivision (*a*), containing the name and address of each taxpayer, the business in which engaged, the amount of invested capital and net income shown by the return, and the amount of invested capital as determined under such subdivision. The Com-

missioner shall furnish a copy of such record and other detailed information with respect to such cases when required by resolution of either House of Congress, without regard to the restrictions contained in section 257." (Italics ours.)

No unreviewable discretion is indicated by the language of this Section. In fact, Congress was very specific in its directions as to the kind of corporations with which a comparison should be made and as to how the tax should be computed. Ordinary *judgment* is all that was called for on the part of the Commissioner. When Congress so specifically directs how the comparison shall be made, and how the average tax shall be arrived at, it would appear that not nearly as much "discretion" or opportunity to exercise judgment, was given the Commissioner as was given in other sections of the law, such as in the determination of a "reasonable allowance for compensation of officers" and other similar provisions of the act, referred to in pages 19-22 herein.

The true and full significance of the petitioner's appeal in this case is that he has resented both the investigation of his Bureau by Congress and the creation of the Board of Tax Appeals to review his determinations. He has attempted to write into the Revenue Act of 1924 an *implied* exception based on language used in a former act enacted at a time when Congress was satisfied with the administration of the Bureau of Internal Revenue.

The petitioner evidently doubts the wisdom of Congress when it created the Board of Tax Appeals. A

great majority of the taxpayers probably do not agree with his views. But the question herein does not depend upon whether the petitioner's administration should have been criticised, or whether Congress acted wisely in creating the Board. It is whether an *implied* exception may be written into the very plain language of the 1924 Act.

V.

The Board has jurisdiction to review the petitioner's determination for both the years 1918 and 1919, as Section 274 (g) of the Revenue Act of 1926 does not affect appeals filed with the Board prior to the enactment of said act.

The petitioner has also asserted that the Board has jurisdiction in this case only over the year of 1919 because he had determined an additional assessment for that year of $10,240.09 and an overassessment of $9,296.17 for 1918, or a net deficiency of $943.92.

The Commissioner made his final determination in respect to *both* years in his deficiency letter. Section 281, Revenue Act of 1924, provided that where there had been an overpayment for one year the amount thereof "shall be credited against any tax or installment thereof then due from the taxpayer * * *." The Commissioner was by law forced to handle both years together and, at least, having so handled them, the Board could not arrive at the correct amount of any deficiency for 1919 without at the same time considering 1918. The Board carefully considered this question of jurisdiction in the Appeal of E. J. Barry,

1 B. T. A. 156. It held it had jurisdiction and the Commissioner published notice of acquiescence in said decision (Int. Rev. Cum. Bull., C. B. IV-2-1).

When Congress enacted the Revenue Act of *1926* it changed this rule as to appeals filed thereafter. Section 247 (*g*) provides as follows:

> "Sec. 247 (*g*). The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid."

Even if this was to be given a retroactive effect, applicable to appeals filed prior to the enactment of the 1926 Act, it would still be necessary for the Board to retain jurisdiction of 1918, because in auditing the 1919 return invested capital has been reduced by the amount of the 1918 tax as determined by the Commissioner, whereas if said 1918 tax liability is excessive, as alleged by the respondent, invested capital for 1919 has been reduced too much. Section 274(*g*) above would at least give the Board jurisdiction of 1918 for that purpose.

It is the accepted rule of statutory construction that any law shall not be deemed to have retroactive effect unless clearly provided for.

25 R. C. L., p. 787;

U. S. *v.* St. Louis, San Francisco & Texas Ry. Co., 270 U. S., 1;

Schwab *v.* Doyle, 258 U. S., 529;
Eidman *v.* Martinez, 184 U. S., 578;
White *v.* U. S., 191 U. S., 545;
Story, Const. Sec. 1398.

Furthermore, this objection should be raised, if at all, in the proceeding on the merits of the case now pending before the Board.

The petitioner expresses concern lest courts and juries review his determinations under Sections 327 and 328. It would be much easier for a court or a jury to determine the issues arising in such cases than under almost any other section of the revenue acts. Whether one business is "like" or "representative" of another is a simple issue. Whether a "hardship" exists is a matter of simple comparison. The arrival at an average percentage of net income paid as profits tax is merely a simple problem in addition and division. As a matter of law, not many issues of fact under these sections would even be submitted to a jury.

It is clear that no jury will ever pass upon the present or any other case appealed to the Board of Tax Appeals. Those taxpayers who have elected so to do have only a right to appeal to a circuit court of appeals. Why does the appellant fear review by a court? Does he think the judges of the courts are less intelligent than the clerks employed by the Commissioner of Internal Revenue? His concern is not understandable.

VI.

The recent decisions of the United States Court of Claims in the case of Williamsport Wire Rope Company v. The United States, and of the United States District Court for the Northern District of Ohio in the case of The Feilbach Company v. Niles, Collector, are not in point in a case involving the jurisdiction of the United States Board of Tax Appeals.

The petitioner quotes as Appendix A in his brief the decision of the Court of Claims of the United States, in the case of the Williamsport Wire Rope Company *v.* The United States (decided May 2, 1927). The facts in that case are partly similar to your respondent's 1919 case, where the Commissioner has refused to act under Section 328. Your respondent's 1918 case is *not* similar to the above case, because the Commissioner *has* acted under Section 328, and the court indicates that if the Commissioner *had* so acted, the way would then have been paved for the review of his decision.

Our case is also distinguishable as to both years in that we have involved none of the problems regarding the statutory consent of the Government to be sued.

The Court of Claims finds difficulty in many cases with this problem of consent to be sued. It recently found similar difficulty in the case of the Toxaway Mills Company *v.* The United States, 61 Court of Claims 363, in respect to which the Government later confessed error in this Court on certiorari. The peculiarities of the practice before the Court of Claims

have nothing to do with an appeal before the Board of Tax Appeals, a part of the Executive Branch of the Government.

With all due respect to said court, we assert its decision should be reversed in the proceedings before this Court on certiorari (No. 337). It takes the position that since the Commissioner computed the taxes under Section 301, instead of Section 328, no contest may be had before that court except as to the computation under Section 301; that if the Commissioner *had* determined the tax under Section 328, the court could then review his action.

As illustrating the unsound reasoning of said court, if a corporation had had its tax liability computed under the individual income and surtax rates provided by Sections 210 and 211, Revenue Act of 1918, and had sued in the Court of Claims, pointing out that it should be assessed either under Section 301, 302 or 328, the court would take the position that it could not review the Commissioner's action unless he had acted under said Sections 301, 302 or 328.

The Commissioner, the Board of Tax Appeals or a court cannot arrive at a taxpayer's true tax liability unless they apply all applicable sections of the law. If a case properly falls under any section of the law and the Commissioner refuses to apply that section, his error should be reviewed.

The petitioner has also printed as Appendix B, in his brief, the decision of Judge Killets, in the case of The Feilbach Company *v.* Niles, Collector, a case arising under Section 210 of the Revenue Act of 1917.

While the statutes involved are different, and we are not informed as to the allegations of the petition, we wish to refer back to pages 25 to 31 herein where similar language has been used in the various Revenue Acts and cases thereunder have been the subject of a large amount of litigation with no suggestion of "unreviewable discretion." We frankly disagree with the reasoning of the decision and commend to this Court, by way of comparison, the excellent and carefully considered opinions of the Board of Tax Appeals (1 B. T. A., 159, R., 17) and the Court of Appeals, District of Columbia (17 Fed. (2d), 663, R., 44), in the case herein.

Respectfully submitted,

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APPENDIX A.

Section 210, Revenue Act of 1917.

"Sec. 210. That if the Secretary of the Treasury is unable in any case satisfactory to determine the invested capital, the amount of the deduction shall be the sum of (1) an amount equal to the same proportion of the net income of the trade or business received during the taxable year as the proportion which the average deduction (determined in the same manner as provided in section two hundred and three, without including the $3,000 or $6,000 therein referred to) for the same calendar year of representative corporations, partnerships, and individuals, engaged in a like or similar trade or business, bears to the total net income of the trade or business received by such corporations, partnerships, and individuals, plus (2) in the case of a domestic corporation $3,000, and in the case of a domestic partnership or a citizen or resident of the United States $6,000."

"For the purpose of this section the proportion between the deduction and the net income in each trade or business shall be determined by the Commissioner of Internal Revenue in accordance with regulations prescribed by him, with the approval of the Secretary of the Treasury. In the case of a corporation or partnership which has fixed its own fiscal year, the proportion determined for the calendar year ending during such fiscal year shall be used."